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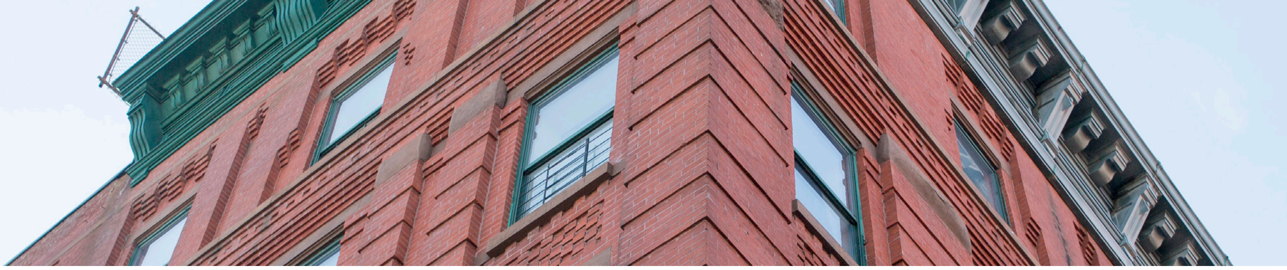

FINANCING MULTIFAMILY REHABILITATION IN NEW YORK CITY

The Problem

New York City has one of the oldest housing stocks in the country, with 56% of all rental units being built pre-1960 (more than 60 years old) and about 40% in 1939 or earlier[1], leading to a median residential building age of 90 years[2]. These pre-war, often rent stabilized, buildings are one of the largest remaining sources of the city's naturally occurring affordable housing. In order to maintain habitability, many of these buildings are in need of major capital investment in essential repairs and renovations, including systems replacement, new roofs, and new windows. This need is especially pressing for aging multifamily buildings with less than 50 units since these buildings tend to be older, operate on thin capital margins, and are often occupied by lower income tenants living in rent stabilized units.

New York City's one million rent stabilized housing units (44% of total rental units citywide) came under uniquely different regulations since the passing of The Housing Stability and Tenant Protection Act (HSTPA) of 2019, which curtailed the deregulation of rent stabilized apartments, eliminated the vacancy bonus upon unit turnover, limited landlord building-wide and apartment improvements, and increased tenant protections[3]. This new regulation combined with 1.5-2.5% rent increase cap for stabilized units and the expiration of the J-51 tax incentive has left landlords of rent stabilized units without a viable path to recoup their investment in much needed renovations. Additionally, building owners will soon need to invest in building decarbonization and other sustainability measures to comply with new local laws and statewide climate goals, leading to more unsupported expenses. In some cases, rent stabilized property owners are choosing to keep units in need of renovation vacant because they determine that it is less costly to forego the rental income than it is to finance the necessary renovations without any revenue-generating opportunities. With historically low residential vacancy rates, historically high home rental and sales prices, and rising interest rates, action is needed to support the investment in the long-term rehabilitation and maintenance of New York City's affordable housing stock.

An Important Financing Tool for Affordable Housing Preservation

For much of the second half of the 20th century, the J-51 tax abatement served as a powerful tool to support the renovation of New York City housing. In 1955, the City Council created the J-51 tax abatement to offset up to 75% of rehabilitation costs and to encourage owners to renovate their multifamily properties with the installation of modern hot water and plumbing systems. The tax benefit provided a 14-year (for non-affordable housing projects) or 34-year (for affordable housing projects) real estate tax increase exemption in exchange for rent stabilization for the duration of the exemption period[4]. By 1977, over 675,000 rental units were upgraded using the abatement. As of 2011, nearly 600,000 units were still receiving J-51 benefits[5] and as of its expiration in 2022, there were 2,815 properties encompassing 94,185 units still receiving J-51 exemptions[6]. In the program's later years, outdated cost schedules made renovations less economically feasible. Over time, use of the program dwindled and J-51 was allowed to expire during the FY23 budget negotiation. While J-51 hasn't been the perfect solution in recent years, its absence leaves a massive gap as building owners are left without any tools to offset the costs of major capital investments.

SNAPSHOT: NYC RESIDENTIAL BUILDING STOCK	
Share of Rental Units Built Pre-1960	56%
Share of Rental Units Built Pre-1940	40%
Median Residential Building Age	90 Yr
Number Rent Stabilized Units	1 M
Rent Stabilized Units as a Share of Total Rental Units	44%
Number of Vacant Rent Stabilized Units	43,000
Contract Rent Estimate for Rent Stabilized Units	$1,400

[1] U.S. Census Bureau, American Housing Survey. 2021.
[2] RentHop, Building Age and Rents in New York City. August, 2017.
[3] Housing Justice for All, Housing Stability and Tenant Protection Act of 2019. 2022.
[4] NYU Furman Center, Directory of NYC Housing Programs. 2022.
[5] Citizens Housing and Planning Commission of New York, J-51 and Gentrification.
[6] NYU Furman Center, CoreData.nyc. 2022.

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As illustrated by the 2021 Housing Vacancy Survey, New York City currently has 43,000 vacant rent stabilized units, an invaluable segment of affordable housing that could house just shy of 110,000 New Yorkers[7], that are off the market because property owners cannot finance the renovations needed to make them habitable. The lost potential of these vacant units becomes particularly acute when considered alongside the over 100,000 different homeless adults and children who slept in a New York City homeless shelter in 2021[8]. A reasonable rehabilitation incentive could help transform these vacant units from a wasted resource into stable, affordable homes for New Yorkers who need them most, and at a fraction of the cost and time that it would take to build the same amount of units from scratch.

Unit Rehabilitation Case Study

To illustrate the realities of the need in current market conditions, CPC ran a per unit cash flow analysis of two hypothetical units – one rent controlled and one rent stabilized – both in need of $50,000 worth of rehabilitation in order to be habitable. The owners of these units are faced with the choice between investing in repairs to make the unit habitable or keeping the unit vacant at a loss to avoid repair costs. If the rent is low enough, both choices incur a financial loss, but there is a tipping point at which one choice becomes less burdensome to the owner than the other. Using fixed assumptions reflective of market conditions and trends[9] , our analysis found that a one bedroom unit in need of $50,000 worth of repairs has a break even monthly rent of approximately $670 – rent any lower makes the repairs more costly than keeping the unit vacant. If the repairs needed cost is $100,000, the breakeven point for rent on a one bedroom unit rises to approximately $1,100. While a breakeven point is illustrative, it is important to note that building owners are more likely to make investments that generate a return, not just to break even.

According to the 2021 Housing Vacancy Survey, the contract rent estimate is $858/month for occupied rent control units and $1,400/month for rent stabilized units – both of which exceed our tipping point, but as our analysis illustrates in Figure 1, the economics of renovation leave the unit owner without much possibility at all of garnering a return on their investment.

RENT STABILIZED UNIT IN NEED OF $50K REPAIRS	WITH REPAIRS	NO REPAIRS, VACANT
Monthly Rent	**$1,400**	**$1,400**
Total Annual Income	$15,960	$ -
Total Expenses	$10,196	$7,596
Annual M&O Expenses	$6,500	$3,900
Annual Taxes	$3,696	$3,696
Net Operating Income (Cash Flow)	$5,674	$ -7,596
Equity Invested in Repairs	$50,000	$ -
Net Present Value (Discounted Return) Over 12 Years	$5,643	$ - 73,793

RENT CONTROLLED UNIT IN NEED OF $50K REPAIRS	WITH REPAIRS	NO REPAIRS, VACANT
Monthly rent	**$858**	**$858**
Total Annual Income	$9,781	$ -
Total Expenses	$8,765	$6,165
Annual M&O Expenses	$6,500	$3,900
Annual Taxes	$2,265	$2,265
Net Operating Income (Cash Flow)	$1,016	$ - 6,165
Equity Invested in Repairs	$50,000	$ -
Net Present Value (Discounted Return) Over 12 Years	$ - 39,249	$ - 59,892

Fig 1. Per unit cash flow analysis illustrating the economics of financing renovation of a rent controlled and rent stabilized unit.

[7] New York City had an average of 2.55 people per household in 2020, according to the New York City Department of City Planning's Population Division's 2022 report "Declines in Household Size & Ramifications for Growth."

[8] Coalition for the Homeless, Basic Facts About Homelessness. July 2022.

[9] Note: this analysis is discounted at 6% to account for net present value.

Both examples yield a greater relative discounted return with the repairs completed, but both units would be less profitable for the property owner over those years due to the upfront cost of renovations. While it may seem counterintuitive, some property owners will choose to forego the renovations, especially if the owner is operating on a shorter time horizon (less than 12 years), does not have equity to invest immediately, and/or already has tight margins on cash flow. In both cases, the significant capital financing gap could be filled by a new major capital repairs tax incentive. While the specifics will vary from unit to unit and the property owner's decision making process will depend on their specific finances and time horizon, a new multifamily rehabilitation incentive could make these repairs more feasible across the board, returning the full value of the investment to the property owner through reduced taxes over 10-15 years.

Additional Bonus for Decarbonization

With the additional costs of retrofitting to comply Local Law 97 and new iterations of the building code, even more property owners could soon find themselves in need of help to close significant financing gaps and avoid penalties. A modern tax abatement program for comprehensive renovation of multifamily rental buildings must account for the impacts of climate change and meet new citywide carbon emissions standards as outlined by Local Law 97. New York City's buildings currently account for 75% of the city's greenhouse gas emissions, providing both a challenge and an opportunity for transformation. To ensure that affordable housing is brought up to newer, healthier, greener standards without emptying property owners building reserves, a new multifamily renovation tax abatement could include a deeper abatement bonus for decarbonization and resiliency efforts. See below for illustrative estimates of potential covered costs[10].

	SMALL MULTI-FAMILY (UP TO 19 UNITS)	LARGE MULTI-FAMILY (20+ UNITS)
Energy efficiency upgrade via building shell renovation ($/housing unit)		
Basic Energy Efficiency Upgrade via Building Shell Renovation	$13,011	$22,669
Deep Energy Efficiency Upgrade via Building Shell Renovation	$41,353	$32,775
Heating, ventilation, and AC conversion to heat pumps ($/housing unit)		
Installation of Air Source Heat Pumps	$13,643	$26,873
Installation of Ground Source Heat Pumps	$25,515	$39,974

Fig. 2: Key cost estimates for sustainability renovations in housing as of 2022.

[10] New York State Climate Action Council, Draft Scoping Plan Integration Analysis. 2022.

A Critical Moment: The Opportunity for a New Tax Abatement for Multifamily Rehabilitation

The compounding challenges of aging infrastructure, tight rent regulation laws, tumultuous market conditions, and the need for decarbonization and energy efficiency upgrades require new and innovative solutions to support property owners in making major capital repairs. By introducing a new tax incentive, New York City can facilitate more cost-efficient major capital repairs of multifamily properties. To increase its efficacy, a new rehabilitation tax incentive would need to have an updated cost schedule that accounts for the current economic and material goods environment, and this cost schedule should be reviewed and updated every year in order to remain current. A new incentive should also have the flexibility to support investments in building electrification and decarbonization as the city works towards reducing building greenhouse gas emissions.

> **It is important to put forth a reasonable proposal before the next legislative session as New York City is currently facing a major affordability and housing supply crisis.**

The City Council and State Legislature must address the needs of the aging and offline housing stock immediately. Housing leaders should work with a cross-sector group of stakeholders to develop this new model. While an incentive for major capital repairs is not new to New York City property owners, the unique value it could provide in this current market context opens a novel and impactful opportunity to bolster the city's stock of affordable, modern, and sustainable rental homes – an opportunity the city cannot afford to delay any longer.

About The Community Preservation Corporation (CPC)

CPC is a nonprofit multifamily finance company that was founded in 1974 to provide financial resources to stabilize and revitalize underserved communities. Today, CPC uses its unique expertise in housing finance and public policy to expand access to affordable housing and drive down the costs of housing production, advance diversity and equity within the development industry, and impact the effects of climate change in our communities through the financing of sustainable housing. Since its founding, CPC has invested over $14 billion to finance the creation and preservation of more than 225,000 units of housing through its lending and investing platforms. CPC is a carbon-neutral company and has been rated AA- by S&P.

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